



## REVOCABLE TRUSTS

### A Private Clients Group White Paper

The Revocable Trust (often referred to as a “Living Trust”) is a popular and effective estate planning technique used throughout the United States. Its advantages (and disadvantages) should be understood by any person interested in selecting the most effective means of managing and disposing of his or her estate.

#### What is a Revocable Trust?

A “trust” is a legal entity created to own, manage and eventually dispose of property. A trust involves a legal relationship between three parties: the “Grantor” (often also referred to as the “Settlor”), the “Trustee” and the “Beneficiary.” The Grantor creates the trust, determines its terms (e.g., the purposes and duration of the trust) and contributes property to fund the trust. The Trustee takes legal title to the trust assets and invests and manages those assets pursuant to the terms of the trust. The Beneficiary receives the use and enjoyment of the trust assets, usually at the discretion of the Trustee and within guidelines provided by the Grantor in the governing trust instrument.

A Revocable Trust is a multi-purpose trust that will operate very differently at three distinct points in time:

- While you are alive and capable of managing your affairs, you generally will be the sole Beneficiary and the sole Trustee or a co-Trustee of your Revocable Trust. During this time, your Revocable Trust serves simply as your “alter ego,” and you control and use the trust property much the same way you would without the trust.
- If you become incapacitated (e.g., by illness or injury), your named successor Trustee steps in to manage the trust assets on your behalf. You remain the trust Beneficiary and trust assets remain available for your use and care.
- After your death, your Revocable Trust acts like a Will by disposing of the trust funds to or for the benefit of your named successor Beneficiaries.

#### What is the Principal Purpose of a Revocable Trust?

The principal purpose of a Revocable Trust is to provide a means for the efficient management, protection and distribution of your assets during your lifetime, in the event of incapacity, and after your death. In most cases, a Revocable Trust operates without the need for any court supervision, generally resulting in increased efficiency and reduced costs when compared to many other estate planning vehicles.

If you die without first establishing a Revocable Trust, a probate court will oversee the management and transfer of your “probate assets” (i.e., assets in your name alone, not owned “jointly” with another person or subject to beneficiary designations). The probate court has jurisdiction to supervise the actions of fiduciaries appointed by the court to manage and transfer such property. For example, in Connecticut, the Executor of a decedent’s estate must file a financial report or an accounting of the estate transactions when the administration is completed. Similarly, Trustees of trusts set up under a Connecticut resident’s Will generally must file accountings of all trust transactions periodically. The probate courts review these reports or accountings to insure that the fiduciaries are properly carrying out their duties (e.g., that trust funds are prudently invested, that fiduciaries’ fees are reasonable,

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etc.). Even if excused from the financial reporting requirements, Trustees of trusts set up under a Connecticut resident's Will must be appointed by a court and any resignation or appointment of a Trustee must be approved by the court. For a client who has established a Revocable Trust, many of these probate court procedures become voluntary rather than mandatory.

Similarly, if you become unable to manage your affairs during life and have not established a Revocable Trust, it is generally necessary for a family member to apply to the probate court for the appointment of a "conservator" or "guardian" for you. This usually requires a hearing to determine if the appointment is necessary, examinations and reports by one or more doctors, and the appointment of a "court appointed attorney" to represent your interests at the hearing. Until the appointment is made, no one would have authority to pay your bills or otherwise manage your assets. On the contrary, as mentioned above, if you establish a Revocable Trust and later become incapacitated, the successor Trustee can immediately step in to manage the trust assets on your behalf. Thus, there would be little or no time when bills were not being paid or assets were not being invested. In addition, there would be reduced involvement of "outsiders" in your affairs and reduced expenses incurred by you and your family.

## Are There Any Other Advantages?

Other advantages of establishing a Revocable Trust can include the following:

- If a Revocable Trust is established and funded before death, the Trustees of the trust can immediately manage the decedent's assets at death rather than awaiting court appointment as Executors to do so. This allows the Trustees to respond to market and other economic factors to preserve and safeguard assets.
- One who owns real estate (including condominiums) in more than one state almost always will wish to establish a Revocable Trust to avoid a separate probate in each state. Some married couples with an out-of-state vacation home alternatively may wish to take title "jointly with right of survivorship" and avoid probate in that manner at the death of the first spouse.
- If there are portions of your estate plan that should be kept confidential, a Revocable Trust provides more privacy than a Will does in that usually it does not become a matter of public record. While the need for such confidentiality is rare, it does occur from time to time.
- In some states, a Revocable Trust may be somewhat less susceptible than your Will to challenge by your heirs.
- In almost all states, a surviving spouse has the right to ignore the provisions of a deceased spouse's Will and instead claim his or her "statutory share" of the estate or the amount guaranteed a surviving spouse by law, often one-third of the estate. A few states (including Connecticut) currently permit a married person to defeat this statutory claim of a surviving spouse by placing his or her assets in a Revocable Trust during lifetime (although such laws have been subject to recent criticism).

## Are There Other Ways to Prepare for Incapacity?

Revocable Trusts are not the only means of avoiding the need for a conservatorship or guardianship proceeding in the event of incapacity. For instance, you can appoint your spouse or other family member as your "agent" or "attorney-in-fact" by signing a "durable power of attorney." If you later become incapacitated, the appointed "agent" can present the power of attorney to the institutions where you maintain accounts and begin transacting business on your behalf. Another option is to add a trusted family member as a "joint owner" on your financial accounts, so that he or she can access funds on your behalf at some point in time.

Unfortunately, these latter two options present some drawbacks. For instance, on occasion financial institutions may be reluctant to permit the agent under a power of attorney to enter into certain types of transactions. Delays may occur until the institution's legal department is satisfied that it is safe for it to proceed. Naming someone as a joint owner on your account is generally not recommended, since it permits them to legally make withdrawals for

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their own use, and can subject the account to the claims of their creditors during their life and estate taxation upon their death.

## **Will a Revocable Trust Reduce Legal Fees, Court Costs and Executor's Commissions?**

Yes, but not dramatically so in many cases.

Most attorneys charge legal fees for estate settlement work on the basis of a percentage of the taxable estate (which is not affected by establishing a Revocable Trust) or simply on the basis of the time needed to settle the estate. By and large, establishing a Revocable Trust does not significantly affect the amount of legal time needed to settle large estates and thus does not reduce legal fees in those cases.

Executor's commissions usually will be reduced by using a Revocable Trust, but if you choose to use a family member as Executor, this is unimportant if the family member may not charge a fee in any event. When using a professional Executor, generally you will name that same professional as Trustee of your Revocable Trust upon your death. Accordingly, any reduction in Executor's commissions will be offset by any Trustees' fees charged. As a result, total fiduciary and investment management charges will be much the same whether you use a Revocable Trust or not.

If you intend to establish one or more trusts for your spouse and/or other beneficiaries at your death, then a Revocable Trust agreement can result in significant savings through the years. As noted above, the trusts established under a Revocable Trust are not automatically subject to the same probate court administrative and reporting requirements as are trusts established under a Will. Therefore, depending on family circumstances, it can prove to be significantly less expensive to administer trusts under a Revocable Trust.

In addition, there may be certain state income tax benefits available only to trusts under a Revocable Trust and not to trusts established under a Will.

## **Do I Need a Will if I have a Revocable Trust?**

Yes. Few people will want to (or be able to) transfer all of their assets into a Revocable Trust. Accordingly, if you have a Revocable Trust you will still need a very simple Will (a "pourover Will"), that will serve to add to your Revocable Trust at death any property not added during your lifetime. A Will also is necessary to appoint an Executor, as in most cases the Trustee of your Revocable Trust will not be authorized to handle all matters relating to the settlement of your estate. If you have minor children, you will wish to name a guardian for those children in your Will.

## **Will a Revocable Trust Save Taxes?**

Since the Grantor retains the power to terminate a Revocable Trust at any time, the assets of the trust will be fully includable in the Grantor's estate at death. Accordingly, while a Revocable Trust can be used as the vehicle for tax efficient estate planning, its existence in and of itself does not save estate, gift or income taxes.

## **Does a Revocable Trust File Separate Income Tax Returns?**

If the Revocable Trust has taxable income or tax deductions, the Trustee will have to maintain all of the usual financial and tax records. However, where one of the Trustees is the person who created the trust, the information can be shown directly on that person's own individual tax return (Form 1040) as if the trust didn't exist. In some other situations, a special trust tax return (Form 1041) must be filed, although the income and deductions still will be reported on the Grantor's personal tax return while he or she is alive. Your accountant or tax advisor must be consulted to determine what type of return to file, if any.

## **What are the Disadvantages of a Revocable Trust?**

The disadvantages of a Revocable Trust are largely practical in nature, and include the following:

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## Problems of Transferring Property

If you intend to transfer property to your Revocable Trust during your lifetime (which is not necessary to achieve many of the advantages of having a Revocable Trust), doing so can occasionally prove to be cumbersome, time consuming and sometimes expensive. The nature of the property will determine the degree of inconvenience. For example, transferring cash and securities held in a brokerage account to a Revocable Trust is relatively simple. Transferring real estate becomes more complicated and expensive, as deeds must be prepared and recorded on the land records. Placing a condominium or a cooperative apartment in a Revocable Trust can be very difficult if various Board of Directors' approvals are needed, and may not be permitted under state law.

Schedule A to this client memorandum contains a list of common types of properties and what must be done to transfer them to a Revocable Trust.

## Increased Planning Costs

If you wish to implement a Revocable Trust there will be a legal charge for drafting the necessary Revocable Trust Agreement and the companion pourover Will. It is somewhat more expensive to have two documents (Will and Revocable Trust) drafted rather than one (Will). In nearly every case, however, the existence of a Revocable Trust will sufficiently streamline the management of your affairs to more than recoup the initial setup costs.

## Business Issues

Despite the popularity of the Revocable Trust, many persons and businesses remain unfamiliar with the concept and hesitate to get involved in what otherwise would be normal, everyday transactions with you as an individual. For example, refinancing a home or obtaining a home equity loan may be difficult if the property is owned by a Trustee. Insurance companies and brokerage firms, especially the smaller or more cautious ones, can be difficult to deal with when real estate is owned by a Trustee.

## Lack of Court Supervision

The fact that a Revocable Trust is not subject to the same court supervision as are Guardianships, Conservatorships and Wills (and thus does not incur the costs associated with court proceedings) is often the greatest benefit of a Revocable Trust. However, in certain family situations, the lack of judicial supervision can prove to be a disadvantage if you are worried about your family members or selected fiduciaries abusing their positions of trust or otherwise wasting trust assets. Accordingly, the decision to remove your affairs from the supervision of the probate court is one which should not be taken lightly.

## What is the Difference Between a Revocable Trust and Other Lifetime Trusts?

As noted earlier, Revocable Trusts provide no tax benefits in and of themselves. In contrast, other forms of lifetime trusts often are designed to reduce income, estate and gift taxes. These trusts must be irrevocable, i.e., once they are established, they cannot be revoked or altered.

For example, an irrevocable insurance trust is a trust to which you gift an insurance policy, naming the trust as owner and beneficiary. Normally this is done to remove the insurance proceeds from your taxable estate. Similar irrevocable trusts, referred to as "estate reduction trusts", are used for gifting other forms of property, such as stocks, bonds, cash and real estate. Again, the purpose usually is to reduce estate taxes at death by removing this property from your estate. These irrevocable trusts should be distinguished from the Revocable Trust.

## Who Should Be the Trustee of My Revocable Trust?

In many states, such as Connecticut, New York and Florida, you may serve as your own Trustee. Nevertheless, it will be necessary to name a successor Trustee to act after your death or in the event you become unable to manage the trust.

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The Trustee's duties depend upon the nature of the trust assets, and usually include investment management, tax analysis and tax preparation, safekeeping of trust assets, collection and distribution of income, and general bookkeeping. In addition, depending on the terms of your trust, your Trustee may be required to exercise sound judgment and discretion on matters such as whether to invade trust principal for needy beneficiaries or in deciding to which family members trust income should be distributed.

In selecting a Trustee (or Trustees), you may wish to seek the guidance of your estate planning attorney. For most substantial trusts, you may wish to name a bank or an individual experienced in trust management as a successor Trustee (to act in the event of your death or incapacity), unless you have someone in your family who has the requisite experience and in whom you have complete confidence. Certain trusts created under your Revocable Trust at your death may require the services of an "Independent Trustee" for tax reasons.

You also may wish to involve your husband, wife, child or other family member as a Trustee or co-Trustee so that there will be someone close to the family and responsive to the family's needs. If that person does not have the professional or business background needed to manage the trust assets, a sensible solution is to name a family member and a bank or other experienced professional as co-Trustees. If you wish, your family can be given the power to remove and replace the professional co-Trustee should they become dissatisfied with the services provide by that co-Trustee.

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This document is intended to convey to you the principal characteristics of Revocable Trusts as they apply to common situations. For this reason we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your other advisors rely solely on the contents of this document for technical advice, nor should you reach any decisions with respect to this topic without further discussion and consultation with a Cummings & Lockwood attorney.

In accordance with IRS Circular 230, we are required to disclose that: (i) this memorandum was not intended or written by us to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; (ii) this memorandum was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the memorandum; and (iii) each taxpayer should seek advice on his or her particular circumstances from an independent tax advisor.

## SCHEDULE A

### TRANSFERRING PROPERTY TO A REVOCABLE TRUST

Type of Property	Action Required*	Assistance Needed From
Real Estate	Deed to Trustee	Attorney
Stocks, Bonds	Certificate Reissued in Trustee's Name	Transfer Agent of Company
Brokerage Accounts	Reregister in Trustee's Name	Broker

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Bank Accounts	Reregister in Trustee's Name	Bank
IRAs, Keogh Plans, 401K Plans	Not Transferable but Trust can be Beneficiary**	Plan Administrator
Automobiles	Reregister in Trustee's Name; Change Insurance	Motor Vehicle Department; Insurance Broker
Insurance	Name Trust as Owner or Beneficiary, or Both (First Consider Implementing Irrevocable Insurance Trust)	Insurance Agent
Partnerships	Substitute Trustee as Partner	General Partner
Limited Liability Company	Substitute Trustee as Member	Manager of LLC
Personal Property (furniture, furnishings, etc.)	Sign Deed of Gift and Deliver Property to Trustee	Attorney
Co-Op; Condominium	Deed or Stock Transfer	Attorney; Board of Directors
Employee Benefits (pension, stock options, savings plan, etc.)	Generally not Transferable but Trust can be Beneficiary**	Attorney; Employee Benefits Department

\*Under no circumstances should you transfer any property to a Revocable Trust, or name the Trustee as beneficiary, without first consulting your estate planning attorney. The Revocable Trust can be designated as owner or beneficiary of property by using the name of the trust (if stated in the Trust Agreement) or by language such as "XYZ Bank, Trustee Under John J. Jones Revocable Trust Agreement Dated \_\_\_\_\_, 20\_\_."

\*\*You absolutely should not name your trust as beneficiary of your pension plan, IRA, etc., without first consulting your tax advisor.